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Spa Revenue Management

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Abstract

In principle, spa managers should be able to apply revenue management to spa operations. To do so, however, requires a revision in the way most spas traditionally have viewed sales. Most spa managers track appointments and customer needs, but instead they need to focus specifically on the time element involved in their services. A time-related measure, revenue per available treatment-hour (RevPATH), integrates the price and duration of the treatment as factors in the revenue calculation. Certain elements of current-day spa practice, such as discounting and managing treatment duration, carry the seeds of revenue management, but those are often implemented as tactical measures during particularly slow or busy times. Few spas have established the necessary strategic approach to assemble those tactics into a coherent revenue management strategy. This report establishes a framework for implementing a spa revenue management strategy and sets a practical road map for its execution.

Keywords

spa management, revenue management, revenue per available treatment-hour, RevPATH

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Spa Revenue Management

by SHERYL E. KIMES and SONEE SINGH

In principle, spa managers should be able to apply revenue management to spa operations. To do so, however, requires a revision in the way most spas traditionally have viewed sales. Most spa managers track appointments and customer needs, but instead they need to focus specifically on the time element involved in their services. A time-related measure, revenue per available treatment-hour (RevPATH), integrates the price and duration of the treatment as factors in the revenue calculation. Certain elements of current-day spa practice, such as discounting and managing treatment duration, carry the seeds of revenue management, but those are often implemented as tactical measures during particularly slow or busy times. Few spas have established the necessary strategic approach to assemble those tactics into a coherent revenue management strategy. This report establishes a framework for implementing a spa revenue management strategy and sets a practical road map for its execution.

Keywords: spa management; revenue management; spa revenue

Research in revenue management that we and others have conducted has addressed the theoretical and practical problems facing airlines,

hotels, and restaurants, among other industries (Hanks, Noland, and Cross 1992). So far, we have seen little consideration given to the possibilities for revenue management in spas (see Boyd and Bilegan 2003; McGill and van Ryzin 1999; Weatherford and Bodily 1992). The spa business is similar enough to hotel and restaurant operations that a spa should be able to apply revenue-management principles to the mutual benefit of customers and the operator. Indeed, many spas use various revenue management-type practices, but the application has so far been mostly tactical. We propose here that a broad theory of revenue management would permit spa operators to gain the benefits of strategic revenue management that they currently lack.

The worldwide spa industry is estimated to generate nearly US\$40 billion per year (Haden 2007). In 2005, the spa industry generated \$11 billion in revenue in Canada and the United States. The average annual growth rate is 18 percent in North America, while the growth rate in the Asia-Pacific region is nearly 200 percent. Not surprisingly, spas are considered the fastest-growing sector in the tourism industry (Haden 2007). Spa visits in the United States alone reached more than 130 million per year in 2006, with an annual growth rate of 9 percent (International Spa Association [ISPA] 2006).

With the exception of the large chain hotel and resort spas, the spa industry is thought of being in its developmental stages, quickly growing but with a lack of set global standards. The industry has not seen measures of financial performance or a chart of accounts until recently. In 2003, ISPA, in collaboration with the Association for Hospitality Financial and Technology Professionals, released the first edition of *Uniform System of Financial Reporting for Spas*, and ISPA compiles industry statistics.

A logical way to measure success in the spa industry is a straightforward approach of analyzing the contribution of different revenue streams, managing expenses, tracking the percentage of retail out of treatment revenue, and managing productivity or utilization of treatment areas and therapists. Taking those revenue measurements into account, in this report we propose a framework for how revenue management can be applied to spas. We review the necessary conditions for revenue management; the strategic levers available to spa operators for revenue management; how they have been applied in traditional revenue-management settings; and how they, along with some tactical tools, can be applied to spas.

A Review of Revenue Management

Revenue management is the practice of allocating the right space to the right customer at the right price at the right time so as to maximize revenue or contribution margin (Smith, Leimkuhler, and Darrow 1992). The determination of “right” in that definition entails achieving the most revenue possible for the spa while at the same time delivering the greatest value or utility to the customer. The issue of maximum utility is particularly important for spas because of their direct contact with the guest through the spa experience. Without the balance of revenue and utility, revenue

management-type practices will alienate customers who will feel that the spa has taken advantage of them and has not provided them with the expected service in exchange for their patronage.

In practice, revenue management has meant setting prices according to predicted demand levels so that price-sensitive customers who are willing to purchase at off-peak times can do so at favorable prices, and price-insensitive customers who want to purchase at peak times likewise can do so. The application of revenue management has been most effective when it is applied to operations that have relatively fixed capacity, predictable demand, perishable inventory, an appropriate cost structure, varying customer price sensitivity, and time-variable demand (Kimes 1989; Cross 1997). Those attributes are generally found in some form or another in the spa industry.

Relatively fixed capacity. Spa capacity can be measured by the number of treatment rooms and the time that those rooms are available (with the added factor of ensuring appropriate staffing). Most spa operators approach optimizing revenue by filling the treatment rooms, but that effort can be limited by demand patterns and the number of therapists available. In many spas, the therapists are specialized, and even if a room is available, the appropriate therapist may not be. In the United States in particular, or where there are limitations on therapist licensing, it might be challenging to fill a room set up for facials, for example, when only body therapists are available.

Spa capacity is generally fixed over the short term, although spas have some flexibility to offer remote treatments, hire more therapists, increase the number of operating hours, change the length of the appointment, or reduce the amount of time between treatments.

Predictable demand. Spa demand consists of the two distinct market segments.

One group is customers living relatively near the spa, and the other segment is visitors to the area. Demand by guest type varies depending on the type of spa. Day spas may approach 100 percent of customers being local residents, while resort or destination spas may see all of their demand from visitors staying at the resort. Unlike many hospitality industry segments, spa appointments are not typically booked far in advance and are mostly made at most a couple of weeks in advance. Many spas make appointments only a day or a few hours in advance, although it is true that resort or destination spas often gain reservations at the time the hotel booking is made. In contrast, spas in urban locations or day spas have a relatively high number of same-day reservations.

One key point about spa demand is that it can be classified by type of user. A leisure day user would typically be available to visit the spa anytime during the day, while corporate users or others on a tight schedule would only be available for set times during the day (e.g., before or after work or for an express treatment during lunch).

That dichotomy creates a revenue-management opportunity. Both forms of demand can be managed, but different strategies are required. Different types of demand constitute an inventory from which managers can select the most profitable mix of customers. To forecast this demand and manage the revenue it generates, a spa operator needs to compile information on the proportions of local and visitor demand and of leisure day and corporate evening or weekend demand. In addition, the revenue manager must record the desired treatment times, how far in advance appointments are booked, and the preferred types and lengths of treatments. Tracking customer-arrival patterns requires an effective reservation system, whether by computer or by hand.

Perishable inventory. One might think of a spa's inventory as its rooms and therapists,

but instead, spa inventory should be thought of as time—or, in this case, the time during which the spa's capacity (both rooms and therapists) is available. If the spa is not fully occupied for a period of time, that part of the spa's inventory perishes. This is the key to the strategic revenue management framework, and it is the element we believe has been missing in most approaches to spa revenue management. Instead of measuring costs or revenue for a given month, spa operators should measure revenue or contribution per available treatment-hour (RevPATH). This measure captures the time factor involved in the spa business. Revenue can come from a variety of sources, including regular and upgraded treatment fees and surcharges for particular rooms or therapists.

Many spa companies evaluate operations based on sales volume. This is equivalent to hotels' measuring effectiveness by recording occupancy without paying attention to average rate. While a high volume is desirable, volume alone does not provide the information regarding revenue that RevPATH would give.

Appropriate cost structure. Revenue management works best in industries that have a relatively high fixed cost and a relatively low variable cost. This describes spas, with their sometimes elaborate facilities and essentially fixed labor costs (or at least a fixed labor-cost percentage). Spa sales generally must generate sufficient revenue to cover variable costs and offset at least some fixed costs. Depending upon the spa's geographic location, labor can be considered either a fixed or a variable cost. For example, as explained by spa analyst Andrew Gibson (personal communication, 2008), in Asia, where most therapists are on salary and labor costs range from less than 20 percent to nearly 60 percent of the treatment price, labor is often treated as a fixed cost. Conversely, in North America, said Gibson, most therapists are paid an amount per treatment and labor is considered a variable cost,

although the labor cost is a known percentage. Other variable costs include treatment costs of sales, ranging from virtually nothing (in treatments where no products are used, such as Thai Massage or Shiatsu) up to an average of 15 percent. Thus, spas have some pricing flexibility and can reduce prices during low-demand times.

Since revenue management has more potential in operations with a cost ratio of high fixed costs to low variable costs, it offers more revenue opportunity in spas that treat labor as a fixed cost. This is not to say that revenue management cannot increase revenue in spas that treat labor as a variable cost, but it cannot provide the same level of return. We say this only because, when labor costs are variable and therapists are paid per treatment, the opportunity cost of an unsold treatment time mostly comes from an empty facility and not the cost of paying staff.

Varying customer price sensitivity. The spa industry, like most other industries, has some customers who are extremely price-sensitive. These customers may be willing to plan for a treatment at a less attractive time or in a less desirable room if they can get a discounted price. Conversely, other customers may be price-insensitive and be more than willing to pay a premium to get their preferred treatment time, treatment room, or therapist. Having raised the issue of discounting, we note its dangers. When deciding to offer lower prices, operators must pay particular attention to the effects that any price adjustments may have on the patronage of regular guests. Not only might price reductions annoy regular guests who have paid full price, but an influx of guests attracted by off-price opportunities may also interfere with regular customers. A spa is a place of sanctuary for most guests and unless care is taken, having a larger (and different) market segment in the spa may adversely affect the traditional spa experience.

Time-variable demand. Customer demand varies by the time of year, by the week, by the day, and by the time of day. Depending on the type and location of the spa, demand may be higher on weekends, during high season, or during late afternoons and evenings. Each spa's managers must be able to forecast their operation's time-related demand so that they can make effective pricing and capacity-allocation decisions to manage the shoulder periods.

In addition, the length of the treatment can vary. Some treatments may last for an hour, others for forty-five minutes, and still others for ninety minutes, depending on the treatment and the customer's preferences. Beyond that issue, guests can combine treatments in a long visit to the spa, with packages starting at two hours and including half day (three to four hours) and full day (up to six hours).

Spa operators must also be conscious of their definition of treatment time. Often, an hour treatment only lasts fifty minutes, allowing for a ten-minute turnaround of the room between guests. Some guests are quite aware of the treatment duration and are conscious about whether they are getting a fifty-minute treatment or a full sixty minutes.

Measuring Success

Focusing on RevPATH has major implications for the way in which a spa is operated and evaluated. Many managers currently measure their spa's success by tallying the number of customers served; average spent per guest; utilization of therapists and treatment rooms; percentage of retail revenue; revenue per square foot; revenue per treatment; and, in the case of hotel and resort spas, hotel guest capture rate or spa revenue per occupied guest room. While such measures are valuable for many purposes, they do not explicitly reflect the spa's revenue-production

performance. RevPATH, on the other hand, combines information from the average customer expenditure and treatment room use (or occupancy) to provide a measure of the flow of revenue through the system and to indicate how effectively a spa is using its productive capacity. Revenue streams vary by location, business model, and type of spa, but typically a spa will generate 70 to 85 percent of its revenue from treatments (face and body services and others); 5 to 20 percent from retail; and up to 15 percent from other sources, such as fitness, wellness, nutrition, seminars, and workshops.

Because it embraces capacity use and average expenditures, revenue (or contribution) per available treatment-hour is a much better indicator of the revenue generating performance of a spa than are the commonly used measures that we just mentioned. RevPATH indicates the rate at which revenue is generated and captures the trade-off between average expenditure and facility use. If occupancy percentages increase even as the average expenditure decreases, for instance, a spa can still achieve the same RevPATH. Conversely, if a spa can increase the average expenditure, it can maintain a similar RevPATH with a slightly lower facility use. The balance between average rates and facility use depends in part on the type of spa. High-end spas, for instance, may wish keep rates high to ensure low facility occupancy and thus maintain a quiet ambience and relaxed guest experience, as well as use price to signal the spa's luxury positioning.

RevPATH can be calculated by multiplying the treatment room occupancy by the average treatment-related expenditure per person or by dividing the revenue for the time period in question (e.g., day part, day, or month) by the number of treatment-hours available during that interval. For example, assume that a ten-room resort spa has a 70 percent treatment room

occupancy and a \$200 average expenditure per person on treatments (excluding retail). Its RevPATH is \$140 (calculated by multiplying the 70 percent occupancy by the \$200 average expenditure per person). Alternatively, assume that a twenty-room day spa makes \$1,600 on Fridays between 6:00 and 7:00 p.m. Its RevPATH would be \$80 ($\$1,600 / [20 \text{ rooms} \times 1 \text{ hour}]$). Similarly, if that same twenty-room day spa made \$8,000 over a four-hour treatment period, its RevPATH would be \$100 ($\$8,000 / [20 \text{ treatments} \times 4 \text{ hours}]$), or $\$8,000 / 80$ available treatment room-hours).

Exhibit 1 gives a hypothetical illustration of this principle. The four spa operators have the same RevPATH (\$72, calculated by multiplying the occupancy percentage by the average expenditure per person), but each achieves it in a different manner. Spa A has a facility use of 40 percent and an average expenditure of \$180, while Spa D has a use ratio of 90 percent but an average expenditure of \$80. Spa operators B and C also achieved a RevPATH of \$72, but with varying facility-use and average-expenditure statistics.

The numbers for Spa A are typical of a high-end spa where the operator prefers to have a lower occupancy so a relaxed ambience can be offered, but must compensate for this lower occupancy by having a higher expenditure per guest. Conversely, Spa D's numbers are common for a day spa that has a relatively low average expenditure per guest. To compensate for the lower rates, the operator of this spa must achieve a high volume of business. The trade-off between occupancy and average expenditure is a strategic one, and one that must be carefully considered when positioning one's spa.

RevPATH-Based Strategies

Once operators understand their RevPATH patterns, they can develop strategies for dealing with high- and low-RevPATH periods.

Exhibit 1:

Sample Revenue per Available Treatment-Hour (RevPATH) Calculations

<i>Spa</i>	<i>Occupancy Percentage</i>	<i>Average Expenditure per Guest (\$)</i>	<i>RevPATH (\$)</i>
A	40	180	72
B	60	120	72
C	80	90	72
D	90	80	72

Exhibit 2:

Sample Hourly Revenue per Available Treatment-Hour (RevPATH) for September

	<i>11:00 a.m.</i>	<i>12:00 p.m.</i>	<i>1:00 p.m.</i>	<i>2:00 p.m.</i>	<i>3:00 p.m.</i>
Sunday	24	60	88	82	91
Monday	4	29	32	35	30
Tuesday	6	30	55	46	66
Wednesday	8	27	49	34	28
Thursday	12	28	51	42	37
Friday	15	24	52	46	54
Saturday	28	108	119	126	116

During periods of low RevPATH, managers can either try to attract more customers and increase use or rely on suggestive selling to increase the average expenditure. During high-RevPATH intervals, on the other hand, operators might consider reducing the amount of time between treatments or offering only premium treatments.

The RevPATH calculation can be used at different levels of analysis and for different purposes. At the individual spa level, managers may choose to develop hourly RevPATH figures to help develop a revenue management strategy best suited to their spa.

RevPATH can also be used to evaluate the effectiveness of managers. Here is how that might work. Say that the manager of our hypothetical twenty-room day spa wanted to understand her hourly RevPATH patterns for

September. Obtaining data from the spa's booking or POS system, the manager found that her highest RevPATH periods were on Saturdays from noon to 4:00 p.m. and Sundays from 1:00 to 3:00 p.m. and that her lowest periods were on weekdays before 11:00 a.m. (see Exhibit 2). The manager can use this information to help develop revenue management tactics specific to high and low RevPATH periods.

For example, during the busy periods, the manager may want to consider requiring a credit card guarantee for reservations, reducing the amount of time between treatments, or offering premium services. During her slow periods, she may consider offering specially priced treatments for customers who are available on weekdays—young mothers, perhaps, or retired people, in an effort to build demand.

Exhibit 3:**Spa Time Management Methods**

<i>Method</i>	<i>Type of Method</i>	<i>Tactic</i>
Reduce arrival uncertainty	Internal measures	Forecasting Overbooking
	External measures	Guaranteed reservations Reconfirm reservations Deposits
Reduce duration uncertainty	Internal measures	Treatment design Labor scheduling Communication systems
	External measures	Visual or verbal signals Music
Reduce time between customers		Increased labor Process analysis Communication systems

Managing the Strategic Levers

Although spas appear to possess the conditions necessary for revenue management, we see little evidence that they employ a strategic approach for using the demand-management mechanisms. A successful revenue management strategy is predicated on effective control of customer demand and making use of time management and price management (Kimes et al. 1998). When used appropriately, these levers can be used to increase RevPATH.

Time Management

Spa operators typically face a predictable duration of customer use since they specifically sell time intervals. To allow for better revenue management opportunities and a higher RevPATH, spa managers should consider exerting more control over treatment time. To do this, they can refine the definition of duration, reduce the uncertainty of arrival, reduce the uncertainty of duration, or reduce the amount of time between treatments (see Exhibit 3).

Redefining duration. Although spas explicitly sell time, most guests consider that they are purchasing an experience. The trick is to ensure that guests receive the experience they desire while the spa maintains control of the treatment time. Fine-dining restaurants experience a similar but more complicated issue since they typically cannot sell time (e.g., it is generally unheard-of to ask guests how long they will need the table), but they must nevertheless manage the meal duration to be successful.

Typically, spas offer treatments in blocks of one-hour treatments, or sometimes ninety minutes. In some spas, one-hour treatments actually mean fifty minutes of treatment, plus ten minutes to clean and prepare the room. Spa operators can consider offering different lengths of treatments (perhaps thirty minutes, forty-five minutes, or even two hours) or require customers to purchase multiple treatments during busy periods.

Reducing arrival uncertainty. Spa managers struggle with not knowing whether or how many guests will show up. Most spas take reservations to reduce some of

that uncertainty, but many allocate a few slots during low-demand times for walk-in or last minute business. Reservations give a spa operator a better idea of when customers will arrive, but they do not eliminate uncertainty of arrival, since not all guests honor their reservations, and others arrive early or late. In any of these cases, the spa faces the prospect of unused treatment rooms.

Spas that accept reservations but want to decrease arrival uncertainty can involve their customers in arrival management (external approaches) or avoid involving customers (internal approaches). Perhaps the foremost internal approach is overbooking, which is essentially unheard-of in spas. Instead, spas have generally relied on last-minute business to fill unexpected openings. The primary external approach is to shift the responsibility for arrival to the customer by doing such things as asking for deposits, guaranteeing reservations with credit cards, or reminding customers of their appointment.

Although spas probably will not resort to overbooking when traffic is strong, they might want to investigate a voluntary rescheduling approach. The key to a successful overbooking policy is to obtain accurate information on no-shows, cancellations, and walk-in guests to set levels of overbooking that maintain an acceptable level of customer service. Voluntary rescheduling, already in use by some upscale spas, requires similar knowledge of use patterns. A voluntary rescheduling approach takes effect when managers believe that they will be oversold. The spa offers a consideration to patrons willing to switch their treatment to a slower time. A call far in advance to customers who have reservations at the congested time with the offer of a discounted, upgraded, and added service, or free treatment for switching to an open period, could increase customer good will and increase profit. While displacing customers can make them angry, making

them wait without warning could well be worse. If customers do have to wait, many spas attempt to compensate for the inconvenience by offering guests an upgrade or free items.

Another way for spas to prepare for over-sold conditions (assuming they have sufficient space) is to set up alternative treatment areas (such as in-room or at the pool) and offer these at a discount. In this case, the spa manager would need to be able to bring in on-call therapists. Although many spa operators may prefer not to use ad hoc treatment areas or on-call therapists because of quality control and liability issues, their use may be preferable to not being able to serve guests at their scheduled treatment times.

Alternatively, spas could consider booking an indefinite time, where guests are not given a specific time confirmation but rather a start time range (within the space of an hour, for instance). When calling to confirm, the customer would be confirmed for a time within the stated time range or be offered an alternative time.

Shifting to the customer the consequences of not arriving is a practice that has gained currency—notably, hotels and airlines, which have cut no-shows by using guaranteed or nonrefundable reservations. Although spas have been slow to adopt a similar practice, many now require a credit card to hold the booking, while providing a cancellation period as brief as four hours. Failure to cancel in timely fashion incurs a charge ranging from 50 to 100 percent of the service's cost. Flat-out no-shows are charged in full.

Some spas are experimenting with deposits in place of credit card guarantees. Spas have long required a deposit to make reservations for special times (e.g., Mother's Day, Valentine's Day), although the practice may meet with customer resistance during times of low demand. Rather than require deposits in any form, some spas call their customers the day before to reconfirm their

reservations. The call reminds the customer of the reservation and gives the customer a chance to cancel on the spot, if need be. The calls also create a reasonably solid forecast of the number of customers who intend to honor their reservations.

Reducing duration uncertainty. Efforts to reduce duration uncertainty are complicated by the fact that although customers may know they have a certain length of time for their treatment, their focus is on the experience and not the clock. Therapists and managers alike must work to provide the full spa experience, but do so within a specified (and agreed upon) amount of time. The primary approaches to controlling treatment time are streamlining the treatment process and ensuring that the treatment can be completed in the time allotted. Although therapists are bound to vary in how they administer a treatment, they should be trained on timing of the treatment to maintain consistency.

Spa operators should also focus on developing subtle signals that let the customer know that the treatment is over. For instance, music is set to play for the specific duration of the service, or the therapist uses a chime or bell at the end of the treatment. Often, the therapist offers the guest a beverage to indicate the service period has concluded, and may escort the guest to the next destination.

Reducing changeover time. Reducing the amount of time between customers (changeover time) increases capacity and revenue. If properly implemented, this tactic will not offend a departing customer and should please customers who are waiting. Reducing changeover time has become a common strategy for restaurants and airlines. During busy periods, restaurants try to clear and reset tables as quickly as possible so that the next party can be seated promptly. Many low-cost air carriers boast twenty-minute aircraft turnarounds and have thus been able to increase plane use and increase

revenue (Kimes and Young 1997). If the amount of time between treatments can be reduced from ten minutes to five minutes, say, more treatments can be scheduled and revenue potential will increase. (Of course, if the changeover time is reduced, the impact on therapists must be considered.) A similar result may be obtained by developing a good communication system among therapists and cleaning attendants so that employees know when rooms are ready to be cleaned and reset. It goes without saying that management could analyze and streamline the process of cleaning treatment rooms to minimize changeover time.

Managing Price

People commonly associate revenue management with offering discounts, but discounting is only one part of a revenue management program. When price is used as a tool of revenue management, managers must think beyond discounts and develop methods for offering differential prices that make sense for the demand level at a given time. Hotels and airlines use various rules, sometimes known as rate fences, to offer differential prices on inventory that might otherwise not be sold at all to customers who might otherwise not purchase—while at the same time preventing customers who were going to buy anyway from taking advantage of a discount that they did not actively seek. The room rates in a hotel might vary according to the time of the reservation, the days that the individual is staying, and group or company affiliations that the guest might have. For airlines, the Saturday stayover was a well-known rate fence to separate business travelers from leisure customers. The rate fence can comprise almost any set of rules as long as they somehow make sense to the customer.

In contrast, most spas offer the same prices regardless of the customer's demand

Exhibit 4:**Spa Rate Fences**

<i>Rate Fence Type</i>	<i>Examples</i>
Physical rate fences	Room location Room type (regular or VIP; Asian futon or Western treatment bed; Hydrotherapy room) Size of room (single or double) Therapist Party size Treatment type Absence or presence of certain amenities
Intangible rate fences	Group membership or affiliation Time of day or week Length of treatment When reservation booked Walk-in versus reservation Type of reservations (guaranteed or not) Number of treatments booked

characteristics. An increasing number of spa operators, however, have implemented some kind of pricing differential for busy times and slack times, for example, peak and nonpeak pricing, or weekend and weekday pricing. Two-for-one specials are another alternative, as are special prices for local customers and frequent-customer programs. A good pricing strategy can help a spa operator increase RevPATH. We discuss potential spa rate fences in a moment, but first we must address the issue of perceived pricing fairness.

Although it is possible to charge a higher price solely based on high demand (considered to be a surcharge), customers may resent being charged different prices for essentially the same treatment, unless they perceive a “fair” reason for the price differential (Kahneman, Knetsch, and Thaler 1986; Kimes and Wirtz 2003). Setting a “full” price during high times and then offering discounts during slack or other unfavorable times is viewed as more fair than levying surcharges in the face of strong demand. This may be the reason that revenue management is thought of as a discounting strategy. In determining who pays which

price, managers must develop logical selection methods that make sense to customers without offending their sense of fairness, because customers will go out of their way to punish a business that has acted unfairly (Kahneman, Knetsch, and Thaler 1986).

Rate fences. The purpose of rate fences is to shift demand from busy times to slow periods, to reward regular and reliable customers, and to schedule the highest-margin business at the busiest times. If a spa charges different prices for essentially the same treatment, it must develop logical conditions associated with those prices (Dolan and Simon 1997). For example, someone who has a treatment on a Saturday afternoon may pay a higher price than someone who receives the same treatment on a Tuesday morning, or a treatment in a room overlooking the ocean may cost more than a treatment in a room without a view. Rate-fence conditions such as these are essential for revenue management to be successful.

Spa operators can develop both physical and intangible rate fences (see Exhibit 4). Physical rate fences include treatment room location, size, or type; the therapist;

treatment type; and amenities. Intangible rate fences include group membership or affiliation, time of day or week, treatment duration, presence or timing of the reservation (e.g., whether the customer calls at the last minute), and whether the reservation is guaranteed.

Spa operators may be uncomfortable with the notion of charging higher prices for customers treated in more desirable rooms (perhaps those with a view or with added facilities and amenities) or for particular spa therapists, but some customers may be more than willing to pay such a premium. The spa could also charge extra for customers who desire to use the facilities for a period of time longer than specified in the treatment, as well as those who choose to book at busier times. In consideration of the premium price, the spa can provide added amenities during this time and offer additional refreshments and snacks for those resting and waiting in relaxation areas.

The supply of spa treatment-room time often exceeds the demand in most markets, and managers frequently offer discounted prices in an attempt to fill empty times. While discounting is nearly unavoidable in this instance, the point of revenue management is that any discounts should fit the spa's overall strategy. Broad-scale discounting is dangerous because price is one of the means that customers use to determine the perceived value of a service. In the absence of a rate fence (that is, a reason for the discount), customers will benchmark the discounted price as the "real" price. One tactic to offset this difficulty is to offer upgraded services at the regular price during off-peak times. This approach builds demand for slow periods but does not diminish the customer's perception of the regular price. Beyond off-peak specials and the like, some spas offer added value in the form of additional treatment time and complimentary retail products or

money toward treatments during slow periods to attract business. They also might provide a gift for those who book during non-peak hours to thank them for their patronage, create referral incentive schemes, attract group bookings, shorten the duration of treatments, and create express services to encourage business during the least booked times.

Customers and groups who provide a substantial amount of business can be rewarded with benefits and preferential pricing. Some spas offer discounts to local customers or to people who are employees of certain corporations. Regular customers are sometimes guaranteed desirable treatment times, and spas can offer discounts to customers who make guaranteed reservations by a specified advance time.

Developing a Spa Revenue Management System

When developing a spa revenue management system, a spa operator must first understand her or his spa's current conditions and performance (Kimes 1999). Following this, the operator must evaluate the possible drivers of that performance. This understanding will help managers determine how to improve RevPATH statistics. Finally, the manager must monitor the effects of implemented changes on revenue performance. We describe each of these steps below.

1. Establish the baseline. Most managers know their average labor expenditure, but few can accurately estimate the capacity use or RevPATH of their spa operations. To develop a spa revenue management program, operators must collect detailed information on arrival patterns, occupancy levels, treatment times, RevPATH patterns, and customer preferences by day of week and time of day. This information can be collected from a variety of sources, including the POS system, guest expenditure tallies, and methodical observation.

2. *Understand the causes.* Once the baseline data have been collected, managers should analyze the factors that affect RevPATH and occupancy performance. By understanding why RevPATH and occupancy vary (perhaps by day of week, time of day, or even by room or therapist), operators can gain a better sense of how to best manage and manipulate those variations. Simple tools such as fishbone diagrams can be used to better understand the possible reasons behind demand and RevPATH patterns (see Wyckoff 1984; Apte and Reynolds 1995).

3. *Make recommendations.* After the drivers of the most important issues affecting demand and RevPATH have been identified, managers should develop detailed recommendations on how to increase RevPATH. These recommendations can be divided into two types: those for busy periods (referred to as “hot” periods) and those during slow periods (referred to as “cold” periods).

Hot times. RevPATH strategies for hot periods focus on increasing the number of customers who are served at the maximum price by better managing treatment time and limiting discounts. For example, spa operators may decide to institute arrival management strategies such as requiring credit card guarantees or nonrefundable deposits, they may reduce treatment duration or impose duration limits, or they might reduce the amount of time between treatments. In addition, operators may choose to limit the availability of discounted prices or develop premium-price packages that include enhanced amenities.

Cold snap. During cold periods, the spa can serve additional customers, so this is the time for promotions and discounts intended to drive demand. For example, promotions that target certain market segments (such as local residents or senior citizens) can be developed, and two-for-one treatments and other creative packages can be offered.

Regardless of whether the period in question is hot or cold, managers should analyze the potential impact on occupancy and RevPATH of each action and also assess potential return on investment for each recommendation to ensure prudent decision making.

4. *Implement the changes.* For spa revenue management to be successful, spa operators must ensure that managers and other employees clearly comprehend its purpose and practice. This requires a position-specific training program that helps employees understand their role in spa revenue management and how it can benefit both the spa and employees. For example, spa managers can explain how crucial the receptionist’s role is, since how they manage appointments and apply spa revenue management practices in the bookings will have a direct effect on the spa’s performance. More specifically, their performance can be measured in terms of average revenue per booking, and the spa manager can link this measurement to the spa’s revenue or sales goals.

Similarly, spa managers can explain to therapists how each of the treatments they provide contributes to the spa’s revenue, particularly at the margin. That is, the therapists should know how that one additional treatment that they provided contributed a certain amount toward the day’s total sales and how, if they continue doing one more appointment each day, they will contribute a certain amount more to the spa’s monthly and yearly revenue. A possible performance criterion that ties into revenue management objectives could be average treatment revenue per hour for each therapist.

Additionally, operators should create performance criteria like the ones mentioned above (also commonly referred to as key performance indicators or KPIs) for each employee that tie in with the revenue

management objectives, and align employee-incentive programs to coincide with the revenue management objectives.

5. *Monitor outcomes.* As with any business practice, the success of the spa's revenue management program cannot be ensured without measuring results. After establishing the baseline and implementing the revenue management tactics, operators must develop a system to measure its performance. By monitoring RevPATH, treatment room occupancy, and revenue and by comparing those figures to baseline performance, operators can measure the success of their revenue management program.

Conclusion

Few of the ideas connected with revenue management that we have presented here are novel or untried. Our examples throughout are drawn from actual spas' activities. What we argue for here is a unified framework for developing and implementing strategic differential pricing, rather than just a sporadic or tactical approach.

Spas can adapt the principles of revenue management to increase RevPATH by emulating certain attributes of the industries that use revenue management successfully. The key elements are to establish variable prices based on a customer's demand characteristics and more carefully manage duration. Spa managers can apply differential pricing and logical rate fences to build demand during off-peak periods and to establish appropriate prices for busy periods. Spa operators can make duration more predictable by reducing the uncertainty of when (or whether) customers will arrive, by signaling when the treatment is over, and by reducing the amount of time between treatments.

Many spas practice some of the revenue management approaches described in this article but do not yet have a strategic framework by which to coordinate these practices.

The intent of this report is to explain the elements of such a strategy. The strategies themselves will be as divergent as the many types of spa. Thus, researchers are challenged to use this framework to assist spa managers in identifying revenue management opportunities and to develop appropriate time-management and pricing approaches. In the long run, achieving the full potential from revenue management lies in management's ability to market and manage every available moment of the spa as a distinctive product.

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